
California Aging Power Plant Study

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Aging Power Plants Overview

- The foundation of California's system reliability includes thousands of megawatts of aging steam and gas turbine capacity owned by merchant generators.
- The environmental impact of these resources is significantly moderated by (1) upgrades that have been installed and/or (2) very low capacity factors.
- The current market design and the lack of a capacity market prevents price signals from being provided that are necessary to compensate and retain existing capacity, as well as attracting new investment.
- Near-term policy decisions will weigh heavily in the economic viability of these resources and consequential decisions related to mothballing and retirement, including:
 - Resource Adequacy/MD02 (RA/MD02)
 - Must Offer Waiver Denial
 - Short-Term Reliability Contracts
 - Core/Non-Core

Critical Proceedings Facing Aging Power Plants

- **CPUC Rulemaking to Promote Policy and Program Coordination and Integration in Electric Utility Resource Planning (CPUC Docket R.04-04-003)**
 - Successor rulemaking to the Resource Adequacy docket
 - Decision expected mid to late Summer 2004
 - Resource Adequacy should be assured now
- **MD02 Comprehensive Market Design**
 - Currently incomplete, and problematic, without Resource Adequacy component
 - Excessive mitigation, in the absence of RA/MD02 and a forward market for capacity limits viability of marginal generating plants
 - CAISO to file MD02 revision sixty days after CPUC rulemaking is complete
 - Timeframe for MD02 implementation is still uncertain: Phase 1B no earlier than Fall 2004; Phases 2 and 3 not expected until sometime possibly in 2006

Critical Proceedings Facing Aging Power Plants (cont.)

- **Must Offer Waiver Denial (Amendment 60 FERC Docket ER04-835-000)**
 - Should be eliminated now
 - Should be replaced with standard-form Short-Term Reliability Contracts
- **Core / Non-Core**
 - No formal proceeding exists
 - Implementation will require legislation
 - AB 2006 has core / non-core provision but needs work, including:
 - Still contains utility-build provisions
 - Direct access barriers to entry
 - A healthy market is defined by many buyers and many sellers transacting in different timeframes for capacity and energy

Appendix

Resource Adequacy Should Be Assured Now

- January 22 CPUC Procurement Interim Opinion delays Resource Adequacy until 2008
- By waiting until 2008, no assurance of reliability for next 4 years
- Consumers benefit by requiring adequate reserve margins now
- The Governor, Commissioner Geesman, and President Peevey have expressed their desire to accelerate the date for Resource Adequacy (See also WPTF PetMod to accelerate date to 2006)
- Short-Term Reliability Contracts (STRC) are required until RA/MD02 is fully implemented (CAISO has authority to do so without Tariff Amendment)

MD02 Comprehensive Market Design Hinges On Key Issues Including Resource Adequacy And Mitigation Measures

- Until RA/MD02 is implemented, and absent other interim solutions, the CAISO is expected to continue meeting its reserve requirement implicitly through MOWD
 - The MOWD process should be eliminated now
 - Failure to adequately compensate generators for providing reliability service in the MOWD process inappropriately alters the economic viability of marginal generating plants and contributes to the mothball/retirement decision
 - Interim solutions until full implementation of RA/MD02 must include the CAISO's ability to contract for Short-Term Reliability Contracts (STRC)
- Excessive mitigation, in the absence of RA/MD02 and a forward market for capacity limits viability of marginal generating plants
- Resource Adequacy is the necessary foundation for both interim and long-term market designs
- Interim solutions must be replaced as quickly as possible with RA/MD02 to assure a stable environment for investors and consumers to realize the benefits of economic supply

Must Offer Waiver Denial (MOWD) Must Be Replaced With STRC In The Interim Period Before RA/MD02

- In the absence of an Interim Solution, the CAISO will continue to inappropriately utilize MOWD to meet reserve requirements
- The CAISO has recently filed with FERC several proposed modifications to the must offer obligation (CAISO Amendment 60 filing with FERC, Docket ER04-835-000)
- In addition, a significant portion of MOWD compensation is to be eliminated by the CAISO in Fall 2004 (MD02 Phase 1b implementation)
- Continued reliance on MOWD to meet system needs coupled with the planned reduction in must offer waiver denial compensation put generating units subject to MOWD at increased financial risk, and increases the potential for mothball or retirement of marginal generating plant
- Interim Solution is required now, and until full implementation of RA/MD02
 - STRC, or some other mechanism is required to recover full cost of providing reliability service
 - MOWD should not be used to address problem that should otherwise be solved with RMR contracts or intra-year STRCs

Core/Non-Core Needed To Create An Environment Of Many Buyers And Many Sellers

- In order for large commercial and industrial customers to remain competitive, they need to have choice of suppliers
 - A healthy market is defined by many buyers and many sellers transacting in different timeframes for capacity and energy
 - Unless procurement for the core customers is done through a truly competitive process, the utilities may favor their own facilities without regards to cheaper alternatives
- Allowing large customers to remain competitive helps keep them viable which helps to both keep and create jobs in California
- Retail choice must be introduced thoughtfully
 - First, assure Resource Adequacy; and assure that it applies equally to all LSEs (no free-riders)
 - Do it in a way that does not create new stranded costs; and
 - Do it without creating barriers to entry (e.g. extended regulatory-based minimum stay periods, one-time switch opportunities, or lengthy periods of advance notice of intent to switch)
 - The Resource Adequacy obligation should follow the load (“capacity follows the load”)